BANKING SECTOR REFORMS IN INDIA AND AGRICULTURE CREDIT

A Synopsis

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INTRODUCTION:

Banking system is an important constituent of overall economic system. It plays a crucial role in the attainment of macro-economic objectives. It acts as a vehicle for socio- economic transformation and also as a catalyst to economic growth. It plays an important role in mobilizing the nation's savings and channelizing them into high investment priorities and better utilization of available resources.

Banking sector reforms is an important element of the overall economic reforms in the country. Before 1991, the balance sheet regards the performance of banking sector in India was a mixed one, i.e. strong in widening the credit coverage, but weak as far as viability and sustainability was concerned. Low productivity, low efficiency and erosion of profitability of the banking sector have resulted due to the following reasons:

- Undirected investment and credit programme areas-banks were earning much less than what they could do by alternate deployment of funds.
- Administered interest rate for both deposits and advances, which meant banks, had little control over their profitability.
- Contamination of the loan portfolio, much of which was extended due to lack of standard yardsticks for identification and provisioning of impaired debts.
- Banks suffered from excessive administrative and political interference in their internal management and credit decision[1].

Banking concept came into India in the last decades of the 18th century. From the inception, the Indian banking system can be divided into three big phases:

- Ist phase of Indian banking is from the year 1786 to 1969.
- IInd phase of Indian banking is from the year 1969 to 1991, i.e., the nationalisation of banks and before 1991 reforms in the banking sector.
- IIIrd phase of the Indian banking is after 1991 i.e. after the reforms or the new phase of Indian banking sector.

The basic aim of banking reform is to establish a sound and viable banking system which would help in the development of the economy. At the time of independence, banking system was largely urban oriented and remained out of the reach of rural population.

Commercial banks mostly confined their lending to trade, commerce and industry and treated agriculture as an outcaste. And as agriculture is the very important sector for the sustained growth of the Indian economy. About 70% of the rural households and 8% of urban households are still primarily dependent on agriculture for employment[2]. Since banks did not pay any attention to the farming, the agriculturists were abiding to borrow at a very higher rate of interest with heavy terms and conditions from the money lenders. So, after recognizing the importance of agriculture for the development of India, the Government of India and the Reserve Bank of India have played a major role in establishing institutional framework for increasing credit requirements for the agricultural sector.

For increasing the agricultural productivity in India, banking sector have played a vital role –

- Kisan credit card scheme(KCCS) have been introduced
- Insurance scheme
- Training and consultancy services
- Warehousing and cold storage facilities
- Agro-tech and agro-clinic facilities

We could say that agriculture sector suffered from poor irrigation facilities, expensive credit, strained market, poor infrastructure, fragmented land holdings, etc. So banks should consider these facts to invest more in infrastructure facilities. Such agricultural infrastructure can be improved by banks, as a there are ample prospects for banks to invest in the above activities and make banks more participative through policy implementation and create a conducive environment so that the agriculture sector can be cared for like any other sector.

REVIEW OF LITERATURE:

- ***The focal point of the study made by Vashisht, (1987)[2]*** was to evaluate the trends and progress of commercial banks in India during the period 1971 to 1983. Ratio analysis was used to evaluate the performance of commercial banks with respect to different indicators. However, overall performance of each bank was assessed with the help of relative growth indices. The analysis revealed that commercial banks did very well with

respect to branch expansion, deposit mobilization, credit disbursement and priority sector advances. However, it was observed that banks were plagued with the problem of declining profitability. Indian Overseas Bank secured the top position and Dena Bank was placed at the bottom with respect to overall performance indices.

- ***The study of Haque and Verma (1988)***[3] found the domination of private agencies including agriculture and professional money lenders in the agriculture credit market in many regions. Moreover the highly skewed distribution of institutional credit in favour of relative progressive regions and better off section of agriculture population was likely to generate strong backwash effects, thereby retarding the overall pace of agriculture development. Their concluding remarks suggested a need of more egalitarian credit plan to be made and maintained for rapid and balanced agriculture development of the country.
- ***Dadibhavi's (1988)***[4] attempted to analyze the regional disparities in the distribution of institutional agriculture credit between 1972 and 1985. He further examined whether the commercial banks have gone into the fertile land of cooperatives. The study captured that there is increasing concentration of institutional credit to agriculture in a few regions/states between 1972 and 1985. There is also uneven distribution of credit among the small and large holders. Small holders rather than large holder should get more attention from bank policy makers, as this class of borrowers is already in a vulnerable position. The identification of credit deficit states may serve as guide for branch expansion policy of commercial banks in future. The paper also found that the commercial banks have worked on the fertile land of cooperatives.
- ***Garg (1994)***[5] studied that Indian scheduled commercial banks have achieved remarkable progress in last two decades under study, particularly in branch expansion in rural areas, deposits mobilization and credit deployment to priority sector and small borrowers but their profits have not kept pace their growth and hence, their share in profits have come down, whereas foreign banks with a much smaller geographical spread and resources base, earn almost as much by way of profits as the 20 nationalized banks put together. There is a lot of difference in the pattern of advances and investments and even lending rates of Indian and foreign banks.

- ***Jadhav and Ajit (1996)***[6] analyzed the role of bank in economic development of India during the last five decades. It was observed that despite the overall progress made by banking system in terms of functional and geographical coverage, doubts arise about the viability of the banking system in the coming period. Though financial sector reforms have enabled banks in India to clear their balance sheets and improve their functioning, yet they face challenges especially in providing financial services like leasing, merchant banking, mutual funds, money market and government securities.
- ***Joshi and Little (1996)***[7] observed that on the eve of banking reforms, Indian banking sector was financially unsound, unprofitable, and inefficient. They made a critical examination of the changes that have taken place in the banking sector after reforms. Further, what remains to be done with respect of pre-emption of bank resources, directed credit, deregulation of interest rates etc. in the field of banking sector were also elaborately discussed.
- ***Bhattacharya (1997)***[8] has found PSBs with the highest efficiency among the three categories of bank groups as foreign and private sector banks have much lower efficiencies. However PSBs started showing a decline in efficiency after 1987, private banks witnessed no change and foreign banks disclosed sharp rise in efficiency.
- ***Muniappan (2002)***[9] studied paradigm shift in banks from a regulator point of view. He concluded the positive effect of banking sector reforms on the performance of banks. He suggested many effective measures to strengthen the Indian banking system. The reduction of NPAs, more provisions for standards of the banks, IT, sound capital bare are the positive measures for a paradigm shift. A regulatory change is required in the Indian banking system.
- ***Sahu and Rajasekhar (2005)***[10] revealed that agriculture is a risky activity where farmers face shocks to their income; even though it appears that banks in India have been practicing a tight credit rationing process, while selecting their borrowers.
- ***Nair (2006)***[11] discusses the future challenges of technology in banking. The author also point out how IT poses a bright future in rural banking, but is neglected as it is traditionally considered unviable in the rural segment. A successful bank has to be nimble and agile enough to respond to the new market paradigm and ineffectively controlling

risks. Innovation will be the key extending the banking services to the untapped vast potential at the bottom of the pyramid.

- ***Acharya (2006)***[12] argued that the rural credit system assumes importance because most Indian rural families have inadequate savings to finance farming and other economic activities. The need for agricultural credit arises because modern farm technology is costly and the personal resources of the farmers are inadequate. A farmer's inability or least limited ability to save does not allow him to finance his pursuits and raise better production from his farms.
- ***Madhavankutty (2007)***[13] concludes the banking system in India has attained enough maturity and is ready to address prudential management practices as comprehensively as possible, which an integral part of policy is making. Banking in India is poised to enter yet another phase of reforms once the door opens further to foreign players in 2009. This requires further improvement in technology management, human resource management and the ability to foresee rapid changes in the financial landscape and adopt quickly. At present, there is a huge hiatus between the top management earnings of state owned banks and private, as well as foreign banks. Banks have to lay down sound risk management strategies and internal capital adequacy assessment committees to ensure that they do not diverge from the prudential requirements.

IMPORTANCE OF THE STUDY:

The share of institutional sources in total loan outstanding has increased up to 1980s. But in the reform period the share of institutional sources declined. So there is need to study the changes in the relative role of institutional and non-institutional sources of loan outstanding across the states. The highly skewed distribution of institutional credit in favour of relative progressive regions and better off section of agriculture population is likely to generate strong backwash effects, thereby retarding the overall pace of agriculture development. So a study is needed, to get more egalitarian credit plan to maintain the rapid and balanced agriculture development of the country. With the passage of time, Indian agriculture has also been commercialized and the farmer has to purchase costly inputs like fertilizers, tractors, pump sets from the market to produce more. The agricultural credit as a means to buy these modern inputs, indirectly affects the production process. So a study must be

carried out to analyze the changing credit needs of farmers with the passage of time and the changes in credit disbursement due to different banking reforms. The purpose of the study is to analyze the positive as well as negative after effects of these reforms on agricultural credit in India.

PROBLEM:

In the early 90's, there were so many deficiencies that were prevailing in the Indian economy in the financial sector and in the banking sector too, due to which productivity and efficiency of the system has been eroded, even several public sector banks and financial institution were becoming weak financially and were incurring losses year after year, their customer services were poor, technology became outdated and they were unable to meet the challenges of a competitive environment.

And moreover, agriculture sector suffered from poor irrigation facilities, expensive credit, strained market, poor infrastructure, fragmented land holdings, etc. So banks should consider these facts to invest more in infrastructure facilities. One of the key drivers for the progress of any sector is the availability of credit. In the case of agriculture, it is not only the availability of credit but also the access to adequate institutional credit that matters, since most of agriculturists belong to small and marginal farmer categories. Farmers need much more capital than they can afford to save. Credit is a condition that enables a person to extend his or her control over ownership of resources. It represents mobilization of the savings by intermediaries or government from the people and through such credit operations financial savings are transformed into capital. However credit is not capital, the money obtained from credit provides a command over enough funds to exploit opportunities. Credit is an important input in the development. It plays the role of an accelerator in the agricultural development provided it is adequate in quantity, cheap and development-oriented.

OBJECTIVE OF THE STUDY:

In the light of these issues, the present study on credit flow to agriculture derives its relevance by analyzing the temporal behaviour of variables with the following objectives:

- To examine all India level trends of institutional credit to agriculture before and after the introduction of the banking sector reform, and analyze the contributing factors.
- To examine the relative share of different agencies in lending to agriculture in pre and post reform period.
    1. To give a brief historical background on the origin and growth of the banking system in India.
    2. To examine various policy measures of banking sector reforms.
    3. Performance of Commercial Banks regarding rural and agricultural credit during the study period.
    4. Performance of RRBs regarding rural and agricultural credit during the study period.

ACTIVITY PLAN:

1st semester

Material searching, Synopsis and Dissertation preparation	-	6 months

2nd semester

Completion of second Unit and data collection	-	6 months

3rd semester

Completion of third Unit and submission of one research paper	-	6 months

4th semester

Completion of fourth and fifth Unit and analysis of data collection	-	3months
Writing of thesis work	-	2 months
Submission of thesis	-	1 month

DATA SOURCES AND METHODOLOGY USED:

The study will be exclusively based on the secondary data. The relevant data will be collected from various issues of Report on Currency and Finance (RBI), Banking Statistics (RBI), Report on Trends and Progress in Banking in India (RBI), RBI Bulletin (RBI), Centre for Monitoring Indian Economy (CMIE), Statistical Outline of India (Tata Services Ltd.), and Economic Survey (Government of India). Data will be collected from Handbook of

Statistics (RBI), Economic and Political Weakly, and various websites such as www.rbi.org.in, www.iba.org.in, www.iibf.org.in, www.nabard.org, and Indiastat.com.

Data related to agriculture will be collected from Fertilizer Statistics (The Fertilizer Association of India), Indian Agricultural Statistics (Ministry of Agriculture, Government of India) and Statistical Abstract (Central Statistical Organization, Department of Statistics and Programme Implementation, Government of India). The data related to Co-operative Credit Societies and RRBs will be obtained from the Statistical Statement Relating to Co-operative Movement (NABARD). Scientific methods of statistics and econometrics will be applied for analyzing the data and getting the results to derive logical conclusions. Besides simple statistics like means, coefficient of variations, CAGR, correlation coefficients, the study will also used t-statistics to test statistical significance. Student t-test and ANOVA will be used to test whether there is any significant difference between the variables over different periods. Student t-test will be used to check the hypothesis as to whether there is any significant difference in the variables under study before the banking sector reforms mainly based on Narasimham Committee recommendations, that is, before and after 1992-93. It measures as to whether there is any significant difference between the means of the two samples. Generally the null hypothesis is formulated as if there is no significant difference between the variables and the alternate hypothesis is that there is a significant difference between the variables.

SCOPE AND LIMITATIONS OF THE STUDY:

The study is limited for the period from 1980-81 to 2010-11. The study period has been divided into three sub-periods namely:

First Phase (P1) - 1980-81 to 1991-92 (Prior Reforms Period);

Second Phase (P2) - 1992-93 to 1998-99 (First Reforms Period);

Third Phase (P3) - 1999-00 to 2010-11 (Second Reforms Period).

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